No. 83-1111

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

HEUBLEIN, INC.,

Petitioner,

—against—

GENERAL CINEMA CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Does a forced exchange of stock for stock, occurring by operation of law upon the consummation of a merger, constitute a "sale" within the meaning of Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), and this Court's decision in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), where:

a) the exchange was involuntary, the result of a merger over which the shareholder exercised no influence or control;

b) the shareholder's relationship with the issuer was characterized by an atmosphere of hostility; and

c) there was no likelihood that the shareholder had access to material inside information?

THE PARTIES

The names of the parties to the proceeding are contained in the caption.[1]

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[1] Respondent General Cinema Corporation has no parent company. Subsidiaries or affiliates other than wholly-owned subsidiaries are the following:

General Cinema Corporation owns 80% of the common stock of GCC Communications of Boston, Inc., a Delaware corporation.

The voting securities of each of the following subsidiaries are 50% owned by General Cinema Corporation.

Name	State of Incorporation
Bedford Mall Cinema, Inc.	New Hampshire
College Square Cinema, Inc.	Iowa
Des Moines Drive-In Theatre Company	Iowa
Hanover Mall Cinema, Inc.	Massachusetts
Harundale Cinema, Inc.	Maryland
Harundale Operating Corp.	Maryland
Lincoln Realty Corporation	Nebraska
Meyerland Cinema, Inc.	Texas
Meyerland Leasing Corp.	Texas
*Midway Drive-In Theatre Co.	Iowa
Nashua Mall Cinema, Inc.	New Hampshire
Natick Auto Theatre Corporation	Massachusetts
Omaha Drive-In Theatre Company	Iowa
Polk Realty Corporation	Iowa
Shoregate Cinema, Inc.	Ohio
Westgate Brockton Cinema, Inc.	Massachusetts
Westgate Cinema, Inc.	Massachusetts
Westgate Leasing Corp.	Massachusetts

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* Wholly-owned subsidiary of Omaha Drive-In Theatre Company.

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Respondent General Cinema Corporation ("General Cinema") respectfully requests that this Court decline Heublein, Inc.'s ("Heublein") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

STATEMENT OF THE CASE

This litigation arose out of the acquisition by General Cinema of more than ten percent of the outstanding stock of Heublein's predecessor ("Old Heublein") and the involuntary conversion of General Cinema's shares into securities of R.J. Reynolds Industries, Inc. ("Reynolds") when, despite General Cinema's negative vote and in order to thwart a perceived takeover attempt by General Cinema, Old Heublein merged with a Reynolds subsidiary.

By March 15, 1982 General Cinema had purchased approximately 2,266,500 shares of Old Heublein common stock, thereby becoming a beneficial owner of in excess of ten percent of Old Heublein's outstanding common stock. By October 12, 1982 it had acquired 4,092,900 shares, or 18.9% of those outstanding.

Old Heublein was informed of General Cinema's initial purchases on February 2, 1982 and was hostile to General Cinema's investment from the outset, viewing it as an attempt to gain control of Old Heublein. On February 19, 1982 Old Heublein sued General Cinema and three of its directors, alleging, among other things, that General Cinema was engaged in an unlawful tender offer and attempt to gain control of Old Heublein. The complaint sought to force General Cinema to divest its holdings in Old Heublein. *Heublein, Inc. v. General Cinema Corp.*, 82 Civ. 1062 (MJL) (S.D.N.Y.). Following the filing of the action, Old Heublein constantly reiterated its view —in judicial submissions, filings with the Securities and Exchange Commission and other public statements—that General Cinema was attempting to gain control of Old Heublein.

In April and May 1982, in an effort to resolve their differences, Old Heublein and General Cinema entered into discussions concerning a possible exchange by Old Heublein of part of its wine business for General Cinema's Old Heublein stock. To aid in the negotiations Old Heublein provided General Cinema with information concerning its wine business, which Old Heublein's then President and Chief Executive Officer expressly represented included no material information. The discussions were not fruitful.

On July 29, 1982 the Boards of Directors of Reynolds, its subsidiary R.J. Reynolds Tobacco Company ("Reynolds Tobacco") and Old Heublein approved a combination between Reynolds and Old Heublein pursuant to which Reynolds Tobacco would make a tender offer for up to 11,350,000 shares, or 52%, of Old Heublein's outstanding shares, at a price of $63.00 per share, to be followed by a merger of Old Heublein and Reynolds Tobacco through the exchange of the remaining Old Heublein shares for Reynolds securities valued at $56.83 a share. It is uncontroverted that General Cinema had no foreknowledge of a Reynolds-Old Heublein combination and that General Cinema in no way participated in the negotiation of the merger.

On October 12, 1982 the merger agreement was approved. General Cinema owned 4,092,900 shares of Old Heublein stock (or 18.9% of the outstanding), which it voted against approval of the merger agreement. Old Heublein merged into Reynolds Tobacco, and as a result of the merger, and by operation of law, the 4,092,900 shares of Old Heublein stock owned by General Cinema were exchanged for Reynolds securities at an average price of $56.83 per share of Old Heublein stock.

On that same day, October 12, 1982, Heublein filed its complaint asserting for itself the right to recover profits claimed to have been realized that day by General Cinema on the conversion of General Cinema's holdings of Old Heublein common stock into Reynolds securities pursuant to the merger.

On November 12, 1982 General Cinema moved for summary judgment dismissing the complaint on the ground that the conversion of General Cinema's Old Heublein shares into Reynolds securities pursuant to the Old Heublein-Reynolds merger did not constitute a "sale" within the meaning of Section 16(b).

The District Court granted General Cinema's motion for summary judgment on the basis of the standard set forth by this Court in *Kern County Land Co. v. Occidental Petroleum Corp.*,

411 U.S. 582 (1973). The District Court held that the forced exchange of stock pursuant to the merger was an "unorthodox" transaction subject to a pragmatic method of analysis under Section 16(b), noting that this Court has expressly denoted exchanges pursuant to mergers as unorthodox transactions. (App. B at 21a)[2]

Under *Kern County*, the analysis turns on two factors: "(1) the involuntary nature of the exchange, and (2) the absence of the possibility of speculative abuse of inside information." (App. B at 16a-17a, footnote omitted) As to the first factor, the involuntary nature of the exchange, the District Court held that General Cinema exercised no control over the course of events chosen by Old Heublein's management and that once the merger was approved General Cinema had no viable alternative concerning its Old Heublein shares apart from exchanging them pursuant to the merger. Further, the District Court held that any notion that General Cinema had sought to cause a defensive merger, as alleged by Heublein, was irrelevant. Any such objective constituted mere speculation as to the possible actions of management, not the control of such actions. (App. B at 21a-28a)

On the issue of access to inside information, any implication of access to inside information by General Cinema was negated, the District Court held, by Old Heublein's "uncompromising hostility" toward General Cinema's acquisitions of Old Heublein's shares as well as the fact that General Cinema had no control over any of Old Heublein's directors or any input into Old Heublein's management. (App. B at 28a-36a)

As to the specific information pointed to by Heublein as constituting "inside" information, the District Court held that neither information about Old Heublein allegedly obtained from General Cinema's investment advisor, The First Boston

[2] The Court of Appeals and District Court Opinions appear as Appendices A and B, respectively, to Heublein's Petition. References to these appendices are noted herein in the following manner: "App. A at [page]" and "App. B at [page]."

Corporation, nor General Cinema's knowledge of its own objectives was inside information within the meaning of Section 16(b), for neither had been obtained by reason of General Cinema's insider status. (App. B at 29a-31a) Further, the information provided to General Cinema concerning Old Heublein's wine business did not constitute inside information under Section 16(b) because that information was, by written admission of Old Heublein, not material. In the circumstances of a case where the pragmatic analysis is to be applied, the District Court found a materiality standard appropriate in furthering the objective of Section 16(b), the prevention of speculative abuse of inside information, for non-material information by its definition is not significant to an investment decision and cannot afford an opportunity for speculative abuse. (App. B at 33a-35a)

The Court of Appeals affirmed the District Court's order granting summary judgment, stating that the District Court accurately stated and applied the law as set forth in *Kern County* and "find[ing] his well reasoned opinion persuasive." (App. A at 4a) Particularly, the Court of Appeals stated "that in the *class* of cases of which the present case is representative, where (1) an atmosphere of suspicion, if not hostility, characterizes relations between the two corporations, (2) the exchange of shares is 'involuntary' in that it is effectuated pursuant to a merger over which the investing corporation exercised no control or influence, and (3) there is no likelihood of access to material inside information, § 16(b), the 'paradigmatic strict liability statute,' is inappropriate and will not apply." (App. A at 4a-5a) The Court of Appeals concluded that "while there may be evils to be redressed arising out of this kind of corporate maneuvering, § 16(b) is simply not an antidote to all the ills that may plague the securities market." (App. A at 6a)

ARGUMENT

I. THE DECISION BELOW IS IN FULL ACCORD WITH THE CONTROLLING DECISION OF THIS COURT

A. Under *Kern County* The Application of a Pragmatic Analysis of Section 16(b) Liability to This Case Was Correct

In non-traditional transactions, that is, those not involving "garden variety" purchases and sales, courts use a subjective, or pragmatic, approach in determining whether there has been a "purchase" or "sale" for purposes of Section 16(b). Under that analysis, a Court determines whether the application of Section 16(b) to the particular case will serve the purposes of the statute. In making this inquiry two factors are particularly significant: (1) the voluntary nature of the exchange and (2) the possibility of speculative abuse of inside information. *Kern County Land Co. v. Occidental Petroleum Co., supra,* 411 U.S. at 600.

The District Court's application of a pragmatic analysis in its determination of General Cinema's Section 16(b) liability was clearly correct under this Court's decision in *Kern County.* Heublein's argument that *Kern County* created, for "hostile tender offers," a "narrow exception" to the generally strict liability operation of Section 16(b) and that the Court of Appeals improperly extended the analysis set forth in *Kern County* beyond that case's factual context simply mischaracterizes *Kern County.* In attaching this unduly limited meaning to *Kern County,* Heublein ignores both the rationale of *Kern County* and this Court's explicit recognition that the pragmatic analysis is applicable not only to tender offer situations such as that presented in *Kern County* but to other "borderline" or "unorthodox" transactions as well.

In *Kern County* this Court stipulated that a pragmatic approach to the determination of liability under Section 16(b) should apply where certain so-called "unorthodox" or "borderline" transactions are involved. The rationale for this approach is that the "statutory definitions of 'purchase' and 'sale' are broad and, at least arguably, reach many transactions not

ordinarily deemed a sale or purchase," and that in such situations the purpose of Section 16(b) is best served by a pragmatic—rather than strict liability—approach. *Kern County Land Co. v. Occidental Petroleum Corp., supra,* 411 U.S. at 593-94. Accordingly, under the pragmatic analysis a court inquires "whether the transaction may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information—thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits." *Id.* at 594-95 (footnote omitted).

The Court did not purport to define the "intended limits" of Section 16(b) or to restrict the application of this rationale to tender offer situations. Rather, as noted above, the Court recognized that the statutory definitions are broad and arguably reach "many transactions" on the "borderline." Moreover, the Court expressly noted that such "borderline" or "unorthodox" transactions—which may not be within the purview of Section 16(b)—specifically include "stock conversions, *exchanges pursuant to mergers* and other corporate reorganizations, stock reclassifications, and dealings in options, rights, and warrants." *Kern County Land Co. v. Occidental Petroleum Corp., supra,* 411 U.S. at 593 n.24 (emphasis added).

Not only was the transaction here, an exchange pursuant to a merger, an "unorthodox" transaction subject to the *Kern County* analysis under the explicit language of *Kern County,* but there is no contention that General Cinema's exchange of shares was in any sense a conventional sale. Indeed, the exchange took place under circumstances extremely similar to those present in *Kern County,* including, in particular, in an atmosphere of hostility created by the issuer's belief that the shareholder was engaged in a takeover attempt. "In the instant case, despite the absence of a formal declaration of war, such as is present in a tender offer situation, there are other clear indicia of Old Heublein's uncompromising hostility toward General Cinema's acquisitions." (App. B at 32a) While here the exchange of shares was not pursuant to a defensive merger

arranged in response to a tender offer, the prototype of an unorthodox transaction under *Kern County*, it was pursuant to a defensive merger arranged in response to a perceived takeover attempt. Under these circumstances and the clear language and rationale of *Kern County*, the Court below correctly held that "Whether the present case is best characterized as essentially analogous to those involving frustrated tender offers . . . or whether it is symptomatic of an increasingly common strategy 'for achieving quick and substantial returns' . . . is of no immediate consequence," and affirmed the District Court's application of *Kern County*'s subjective analysis to ensure that the purpose of Section 16(b) be correctly served. (App. A at 5a-6a)

B. The *Kern County* Analysis Was Correctly Applied in This Case

The Court of Appeals' holding that Section 16(b) does not apply to transactions, such as that involved here, where "(1) an atmosphere of suspicion, if not hostility, characterizes relations between the two corporations, (2) the exchange of shares is 'involuntary' in that it is effectuated pursuant to a merger over which the investing corporation exercised no control or influence, and (3) there is no likelihood of access to material inside information"[3] (App. A at 4a-5a) is squarely within *Kern County*, where this Court emphasized the importance of two factors under the pragmatic approach to determining Section 16(b) liability: (1) the voluntary nature of the exchange and (2) the possibility of speculative abuse of inside information. *Kern County Land Co. v. Occidental Petroleum Corp., supra*, 411 U.S. at 600.

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[3] Under this Court's "two-court" rule, the factual issues involved in this case are foreclosed from reargument. *Berenyi v. Immigration Director*, 385 U.S. 630, 635-36 (1967). Moreover, with one exception only—the proxy card submitted by General Cinema at the Old Heublein shareholders' meeting reflecting General Cinema's vote against the Old Heublein-Reynolds merger—the record on General Cinema's motion for summary judgment consisted of writings made by Heublein, its predecessor (Old Heublein), its counsel and its officers and directors.

1. The Application of a Materiality Standard Was Correct

As to the "speculative abuse" factor, Heublein asserts that General Cinema was provided "significant, non-public information regarding the wine division of Heublein" (Pet. at 15),[4] although neither the District Court nor the Court of Appeals found that information to be "significant." Indeed, Heublein's description of the information in this manner begs the question here, since Heublein's dispute with the Court of Appeals' reference to a materiality standard has to do precisely with the question of the significance of information for purposes of Section 16(b). The answer, as the Courts below recognized, is rooted in the purpose of Section 16(b). The District Court reasoned, "If information is not material, it is by definition not significant to an investment decision, and therefore it could not afford an opportunity for speculative abuse." (App. B at 35a) *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119, 1121 (9th Cir. 1978); *Gold v. Sloan*, 486 F.2d 340, 346 (4th Cir. 1973), *cert. denied*, 419 U.S. 873 (1974). This reasoning, which the Court of Appeals found persuasive, is completely consonant with the overall purpose of the Securities Exchange Act to "insure the maintenance of fair and honest markets" and the particular purpose of Section 16(b) to prevent "the unfair use of information which may have been obtained by [a statutory insider] by reason of his relationship to the issuer." Section 2, 15 U.S.C. § 78b; Section 16(b), 15 U.S.C. § 78p(b). The "significance" of information under Section 16(b) is the significance of that information to a market decision, an investment decision. As the Courts below found, this is the concept of materiality whose application to the information about its wine business Heublein expressly disclaimed. (App. A at 3a; App. B at 33a)

[4] References to Heublein's Petition for a Writ of Certiorari are noted in the following manner: "Pet. at [page]."

2. The Second Circuit's Analysis of Voluntariness Was Correct

As to the "voluntariness" factor, Heublein seemingly rejects *Kern County* and argues for a new, "ultimate objective" test. (Pet. at 17) The Courts below were clearly correct to place relevance on the shareholder's control and influence over the particular transaction alleged to constitute the Section 16(b) sale, rather than its supposed "ultimate objective," in light of *Kern County*, where the correct inquiry was "whether a 'sale' within the ambit of the statute took place . . . when Occidental became irrevocably bound to exchange its shares of Old Kern for shares of Tenneco pursuant to the terms of the merger agreement between Old Kern and Tenneco . . ." *Kern County Land Co. v. Occidental Petroleum Corp., supra*, 411 U.S. at 595. In making this inquiry this Court stressed:

> The critical fact is that the exchange took place and was required pursuant to a merger between Old Kern and Tenneco. That merger was not engineered by Occidental but was sought by Old Kern to frustrate the attempts of Occidental to gain control of Old Kern. Occidental obviously did not participate in or control the negotiations or the agreement between Old Kern and Tenneco. Once agreement between those two companies crystallized, the course of subsequent events was out of Occidental's hands.[5]

Id. at 599 (citations omitted). This precise analysis was correctly applied by the Courts below.

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[5] The Court also dismissed the argument, akin to Heublein's "ultimate objective" argument, that "[i]f its takeover efforts failed. . . Occidental knew it could sell its stock to the target company's merger partner at a substantial profit. Calculations of this sort, however, whether speculative or not and whether fair or unfair to other stockholders or to Old Kern, do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information obtained from substantial stockholdings that did not yet exist." *Kern County Land Co. v. Occidental Petroleum Corp., supra*, 411 U.S. at 597. Whether framed as a "voluntariness" or "inside information" factor, the "ultimate objective" of the shareholder is not decisive under Section 16(b).

II. THE DECISION BELOW DOES NOT CONFLICT WITH THE FIFTH CIRCUIT'S DECISION IN *TEXAS INTERNATIONAL AIRLINES V. NATIONAL AIRLINES, INC.* OR THE NINTH CIRCUIT'S DECISION IN *KAY V. SCIENTEX CORP.*

The decisions of the Courts of Appeals for the Fifth Circuit in *Texas International Airlines v. National Airlines, Inc.*, 714 F.2d 533 (5th Cir. 1983), *petition for cert. filed*, 52 U.S.L.W. 3473 (December 20, 1983) and the Ninth Circuit in *Kay v. ScienTex Corp.*, 719 F.2d 1009 (9th Cir. 1983)—in which Section 16(b) was held to apply to purchases and sales of shares—and the decision below represent consistent applications of Section 16(b) and this Court's decision in *Kern County*.

The critical factor in *Texas International*, that which "triggered" the application of Section 16(b), was that the transaction there, a negotiated sale of stock for cash, was entirely volitional. This stands in sharp contrast to the forced exchange by General Cinema. The court in *Texas International* correctly emphasized

> the significance of the factor of voluntariness in the Supreme Court's decision [in *Kern County*]. The Court's sole concern was not that cash-for-stock sales present a greater opportunity for abuse of inside information than do stock-for-stock sales. Rather, language in the Supreme Court's opinion indicates that traditional cash-for-stock sales were excluded from the concept of unorthodox transactions because of their voluntary nature:
>
> > The critical fact is that the exchange took place and was required pursuant to a merger. . . .
> >
> > Occidental could, of course, have disposed of its shares of Old Kern for cash before the merger was closed. Such an act would have been a section 16(b) sale and would have left Occidental with a prima facie section 16(b) liability. . . . But the ***involuntary nature*** of Occidental's exchange, when coupled with the

> absence of the possibility of speculative abuse of inside information, convinces us that section 16(b) should not apply to transactions such as this one.

Id. at 1747 (emphasis added). In the instant case, TI voluntarily entered into the stock purchase agreement with Pan Am before the National-Pan Am merger was effectuated. Despite the alleged lack of access to inside information and therefore the possibility of speculative abuse, the volitional character of the exchange is sufficient reason to trigger applicability of the language of section 16(b). For whatever reason, after the National-Pan Am merger had been approved, TI decided to take the initiative for the course of subsequent events into its own hands rather than wait for the merger to become accomplished. These circumstances do not warrant the creation of an exception to automatic section 16(b) liability.

714 F.2d at 540; footnote omitted.

The clearly volitional character of the stock-for-cash sale in *Texas International* properly excluded that sale from the pragmatic analysis in *Kern County* in a manner wholly consistent with the application of that analysis to the forced exchange in the instant case.

Kay also involved a volitional transaction, although Heublein's characterization of the Ninth Circuit's decision in *Kay* inaccurately suggests a discrepancy with the decision below. Heublein simply labels the Court of Appeals' voluntariness standard a "hands on" control standard, which, it claims, stands in contrast to *Kay*'s "instrumental" cause standard and ignores the factual findings in the two decisions. In *Kay* a director and former majority shareholder and officer of ScienTex Corp. was sued by ScienTex for, *inter alia*, profits earned upon his sale of shares issued to him by the corporation. In holding that the issuance—or "purchase"—was "voluntary," the Ninth Circuit stated:

> It is apparent that Kay caused the overissuance of shares to himself. He initiated contact with the transfer agent for ScienTex, Mr. Russell. Kay set up the meeting attended by him and three of his associates and Mr. Russell. He argued to Mr. Russell that he owned substantially more stock than Mr. Russell's records indicated. It was Kay's powers of persuasion which caused Mr. Russell to alter the records to conform to Kay's claims of stock ownership. The transaction was entirely voluntary with respect to Kay. It was arranged and completed under his direction.

719 F.2d at 1013 (footnote omitted). On the facts before it, the Ninth Circuit's finding of voluntariness was wholly consistent with both *Kern County* and the instant case. In *Kern County*, as in the instant case, the shareholder "obviously did not participate in or control the negotiations or the agreement" pursuant to which the shareholder's shares were exchanged. *Kern County Land Co. v. Occidental Petroleum Corp., supra*, 411 U.S. at 599. In *Kay*, by contrast, Kay's acquisition of shares "was arranged and completed under his direction." Under *Kern County* there clearly is no inconsistency in the Ninth Circuit's determination of voluntariness and that of the Court below.

III. THE LEGISLATIVE HISTORY OF SECTION 16(B) PROVIDES NO BASIS FOR LIABILITY

Heublein's argument that General Cinema's allegedly "manipulative" activity is analogous to "quick profit insider trading schemes known as 'pools'," which, according to Heublein, have "a close connection" to the abuses Section 16(b) was enacted to prevent, is defective first because the analogy itself is unpersuasive. (Pet. at 19) "Pools" are completely different from what happened here. As the District Court noted:

> Plaintiff's analogy to the 1930's "pooling" arrangements is untenable. These pools were secret conspiracies by groups of insiders to manipulate the price of the stock with the intention of deceiving public shareholders. This is hardly comparable to the instant situation. (App. B at 30a n.21)

Indeed, as Heublein admits, the applicability of the analogy here would depend on inference. The facts necessary to show a pool admittedly are not present. (Pet. at 20)

The argument is defective for the further reason that, as the Court of Appeals stated, "Paraphrasing Justice White, while there may be evils to be redressed arising out of this kind of corporate maneuvering, § 16(b) is simply not an antidote to all the ills that may plague the securities market." (App. A at 6a) Old Heublein implicitly recognized this by originally seeking relief against General Cinema pursuant to Sections 13(d) and 14(d) of the Securities Exchange Act, 15 U.S.C. §§ 78m(d) and 78n(d).[6] Section 16(b) simply does not reach every perceived wrong arising out of the acquisition of securities.

CONCLUSION

For the foregoing reasons, Heublein's petition for a writ of certiorari should be denied.

Dated: New York, New York
February 6, 1984

Respectfully submitted,

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[6] Old Heublein's complaint based on Sections 13(d) and 14(d) was discontinued with prejudice by stipulation of counsel, so ordered on November 17, 1982, Docket Entry No. 31, *Heublein, Inc. v. General Cinema Corp.*, 82 Civ. 1062 (MJL)(S.D.N.Y.).